

Discussion of “Financial Literacy and Stock Market Participation”

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“Lack of Literacy prevents households from participating in the stock market.”

The study ...

- ▶ proposes new measures of financial literacy.
- ▶ documents financial illiteracy.
- ▶ suggests causality running from illiteracy to stock-market non-participation.

Is causality so clear?

- ▶ Reversed Causality (1). You may learn about financial markets a lot more once you participate. “Learning by doing.”
- ▶ Reversed Causality (2). I would read boring mutual fund prospects only if I planned to participate in the stock market (e.g. *not* if I am are very risk averse). Becoming literate is a *choice*.
- ▶ Endogeneity. Common unobserved factor that explains both, stock-market participation and financial literacy: *Interest in financial matters*. (May explain why women are more illiterate.)

Is causality so clear?

Is “how much of your education was devoted to economics” a good instrument?

- ▶ It is conceivable that those who were exposed to lots of economics may find financial markets less suspect and therefore participate more in the stock market.
- ▶ Does not address correlation between literacy and planned stock market participation (being literate is a *choice*).
- ▶ Does not address endogeneity stemming from “interest in financial matters”!

Is causality so clear?

Would have been nice to have asked questions like the following.

- ▶ “I started to inform myself about financial matters when I was planning to invest in stocks.”
- ▶ “I do not care about financial markets since I would not want to invest anyway.”
- ▶ “I generally dislike to think about financial matters.”
- ▶ Or the like ...

Is causality so clear?

- ▶ The “true” effect from illiteracy on stock-market participation is likely to be overestimated.
- ▶ Would women be so much worse if they really *had to* think about it?
- ▶ If a policy measure would force individuals to get informed, the effect on stock-market participation may be smaller than suggested by the estimations.
- ▶ (Or much larger, because such a measure would make stock-market participation very salient...?)
- ▶ How important is illiteracy *really*? → Many open issues.

How to Measure Illiteracy

- ▶ Some questions go beyond the necessary knowledge: Questions 6, 7, 8, 9. (By the standards of these questions I may never use a computer or buy liability insurance ...)
- ▶ For myself, question 12 does not have a clear answer. I think it should be rephrased. Question 13 is somewhat vague and hard to answer for me.
- ▶ In contrast, knowing about questions 10, 11, 14, 15 *is* vital.

I would suggest robustness analysis only with questions 10, 11, 14, 15.

- ▶ Is illiteracy the main factor for “inadequate” financial choices?
- ▶ Or is illiteracy endogenous, and willpower to do unpleasant things such as reading mutual fund prospects is the crucial factor?
- ▶ Or are observed choices not inadequate at all?

Policy implications of the paper depend on the answer to those questions.

However, financial literacy *is* staggeringly low. More financial education cannot do any harm!

That's my main message from the paper. It's a very useful one!